Business Council of Australia

SUBMISSION

Submission to Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018

May 2018

The Business Council of Australia draws on the expertise of Australia's leading companies to develop and promote solutions to the nation's most pressing economic and social challenges.

BUSINESS COUNCIL OF AUSTRALIA SUPPORTS PERSONAL TAX CHANGES

The Business Council of Australia welcomes the opportunity to make a submission to the Senate Economics Legislation Committee inquiry into the Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018.

The Business Council urges the Senate to pass this Bill without amendment:

- It will provide personal tax relief to over 10 million Australians. Without change, taxes paid by individuals on average will grow more than 15% over the next decade. In today's terms, this represents an increase of over $3,000 in tax paid per person.
- Without at least starting to tackle bracket creep, the personal tax system will become less progressive, hurting lower and middle-income earners the most.
- Australia's personal tax system will need to be competitive with other advanced economies as workers become increasingly mobile. Attracting the best talent is critical to improving productivity and economic growth.
- With an ageing population reducing labour force participation, it will be imperative that the personal tax system does not discourage people from entering the workforce or from working more hours.

The proposed income tax cuts will complement the progressive reduction in the company tax rate to make businesses more competitive in the global contest for investment. Australia needs to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support the creation of jobs for the future. This requires a tax system that reduces the tax burden on investment, working and other highly valuable and productive activities.

The Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018 delivers a stronger personal tax system

The Business Council supports the three-stage personal income tax plan, which will reduce the tax burden faced by individuals. It will deliver a more competitive personal tax system that improves incentives to work and save. It achieves this while maintaining a highly progressive tax and transfer system.

The Bill broadly aligns with the Business Council's proposals for personal taxes to better reward effort outlined in *Realising Our Full Potential: Tax Directions for a Transitioning Economy.* This report outlined a three-stage transformative tax package for the whole tax system, realising that fundamental changes to Australia's tax system will require time and greater fiscal capacity underpinned by stronger growth.

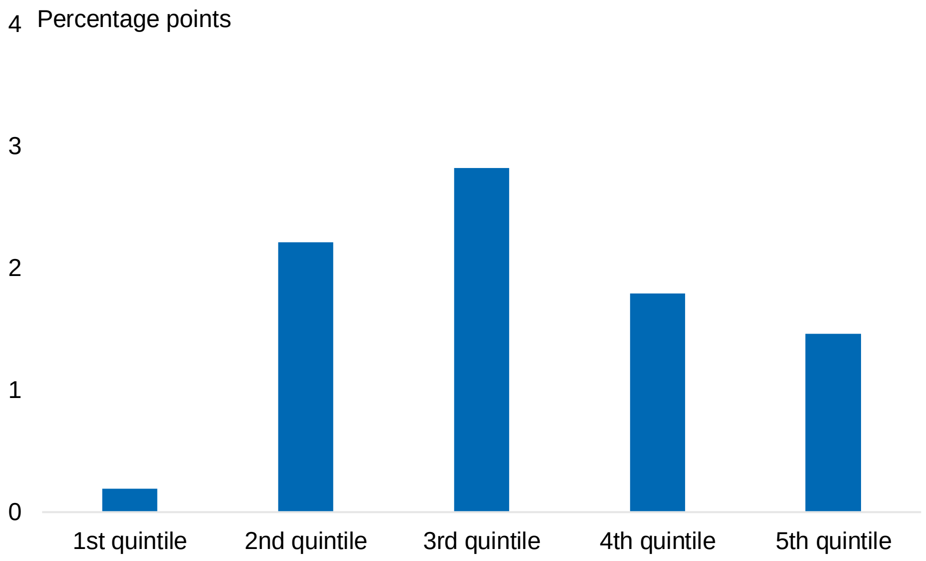
The Government's personal income tax plan provides a sound platform for achieving this broader tax agenda. It is a much-needed circuit breaker, without which taxpayers will face ever-increasing personal taxes and no prospect of relief.

Doing nothing will see ordinary Australians paying much higher taxes

Doing nothing to improve the tax system does not mean nothing will happen. Over the past decade the existing fissures in the tax system have widened. For example, the Parliamentary Budget Office (PBO) has estimated the average tax rate faced by most taxpayers, except the bottom quintiles, have increased over this period.[1]

The government moderated the immediate effect of bracket creep for middle-income earners as part of its Enterprise Tax Plan in 2016. The PBO expects taxpayers in the middle quintiles to face the largest increase in average tax rates over the next four years.

Figure 1: Middle-income earners will be hit the most: increase in average tax rates between 2017-18 and 2021-22, by quintile



Source: Parliamentary Budget Office, 2017, *Changes in average personal income tax rates: distributional impacts*, Report no. 03/2017. Note: these figures do not include the previously proposed Medicare levy increase.

Left unchecked, bracket creep will steadily make the personal tax system less progressive. Bracket creep increases taxes by stealth through inflation. It disproportionately and unfairly hurts lower- and middle-income earners. Bracket creep is regressive and hidden.

Bracket creep means that workers face ever-higher average and marginal tax rates even though their real pre-tax wage has not changed. In a progressive system, this occurs even when taxpayers do not move into higher brackets — all that is needed is that a larger share of income is taxed at the taxpayer's top rate. This reduces the rewards for effort, creates a disincentive to work and gradually reduces the progressivity of the tax system.

[1] Parliamentary Budget Office, 2017, *Changes in average personal income tax rates: distributional impacts*, Report no. 03/2017.

Treasury estimates that if higher revenues from bracket creep are relied on to fund additional spending, GDP would fall by around 0.35% over the long term, or around $6 billion in today's dollars.[2] This reflects the disincentive effects of higher taxes.

Average tax rates will grow unabated if nothing is done

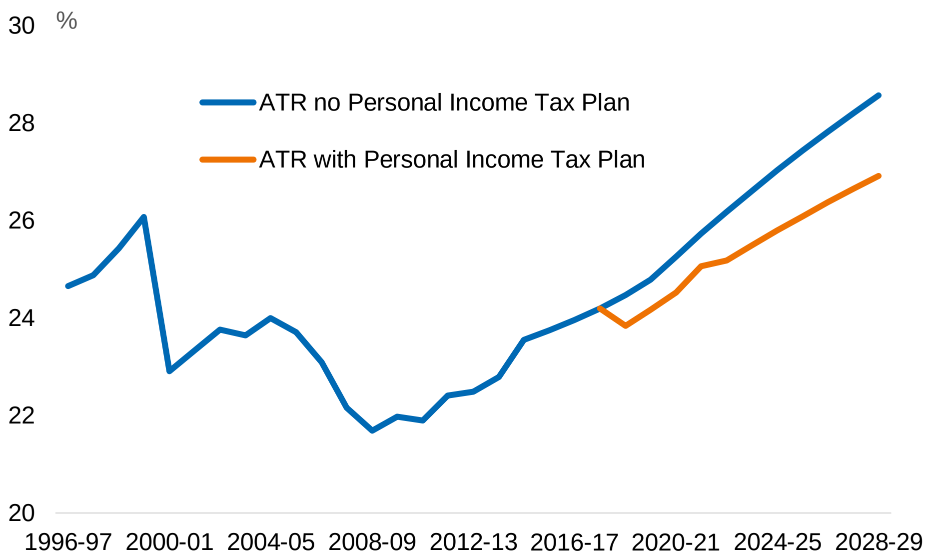
The Business Council estimates that on the latest Budget figures, without personal tax relief the average tax rate on full-time average weekly ordinary time earnings will soar from around 24 per cent today to over 28 per cent a decade from now. In today's terms, this represents an increase of over $3,000 in tax paid per person.

The proposed personal income tax plan provides tax relief for most taxpayers. Those on full-time average weekly ordinary time earnings will see a reduction in their average tax rate over the course of the next decade relative to the current trajectory. Those opposing the Bill are effectively supporting significantly higher average rates of tax for average wage earners.

Apart from the Treasury Laws Amendment (Income Tax Relief) Bill 2016, this is the first income tax relief for many taxpayers since changes in 2012-13. Over 10 million taxpayers will benefit from the tax plan, particularly middle income earners through partial relief from bracket creep.

The improved budget outlook provides the scope for these tax cuts, particularly as tax collections are fast approaching the government's 23.9 per cent of GDP tax cap. But deeper personal income tax cuts and broader tax reform will depend on stronger growth and fiscal discipline.

Figure 2: Average personal income tax rates will soar without relief



Source: ABS cat. no. 6302.0 and Business Council calculations. Note: Average tax rates are calculated using full-time adult average weekly ordinary time earnings and are assumed to grow as per the Budget 2018-19 Wage Price Index forecasts. Analysis includes the Medicare levy and low and middle income tax offsets.

[2] Australian Government, *Release of Tax Modelling* (Canberra: Commonwealth of Australia, 2016).

Australia’s tax and transfer system is highly progressive, but unchecked bracket creep is regressive

Australia has a highly targeted and highly progressive tax and transfer system. Analysis of the potential impact of the proposed Bill, particularly on the progressivity of the tax and transfer system, should take this into account. Analysis should also consider the impact on progressivity of leaving bracket creep unchecked.

Australia’s highly progressive tax and transfer system reflects a combination of features. Under Australia’s personal tax system those on higher incomes pay proportionately more tax, while Australia’s transfer system targets assistance to those households with particular needs. This contributes to a highly progressive system overall. For example:

- the top 3 per cent of taxpayers account for 30 per cent of personal tax revenue and 18 per cent of taxable income[3]
- the transfer system is highly targeted, with the ratio of benefits received by households in the bottom quintile, relative to the top quintile, the highest in the OECD[4]
- the bottom quintile receives 42 per cent of welfare spending, while the top quintile receives 4 per cent[5]
- almost 80 per cent of all benefit spending is means-tested, which is high relative to other OECD countries and more than four times the OECD average.[6]

The proposed Bill will retain these key features of Australia’s tax and transfer system and ensure it remains highly progressive overall. The proposed modest change to the top tax threshold will not undermine the progressivity of the overall tax system. For example, Deloitte Access Economics estimates the share of personal income tax paid by the top quintile will increase from 78.7 per cent in 2017-18 to 81.3 per cent in 2024-25 under the proposed plan.[7]

The Bill sets the right direction and a solid basis for further reform

The Bill does not fully eliminate bracket creep, which requires constant recalibration or indexation of tax thresholds, but the changes are a positive step and provide the foundation for broader reform. High personal tax rates that cut in at relatively low income thresholds mean that people may choose not to work overtime or seek promotion.

The Bill also closely aligns with Recommendation 2 of the Australia’s Future Tax System (AFTS) Review, which called for:

> *Progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity.*

[3] ATO, *Taxation Statistics 2015-16*, 2018.

[4] Peter Whiteford, *The Australian Tax-Transfer System: Architecture and Outcomes*, Economic Record 86, no. 275 (December 2010): 528–44.

[5] OECD, *Social Expenditure Update*, November 2014.

[6] ibid.

[7] http://www.afr.com/news/policy/tax/coalition-tax-cuts-arent-evil--just-maths-says-richardson-20180518-h1091x

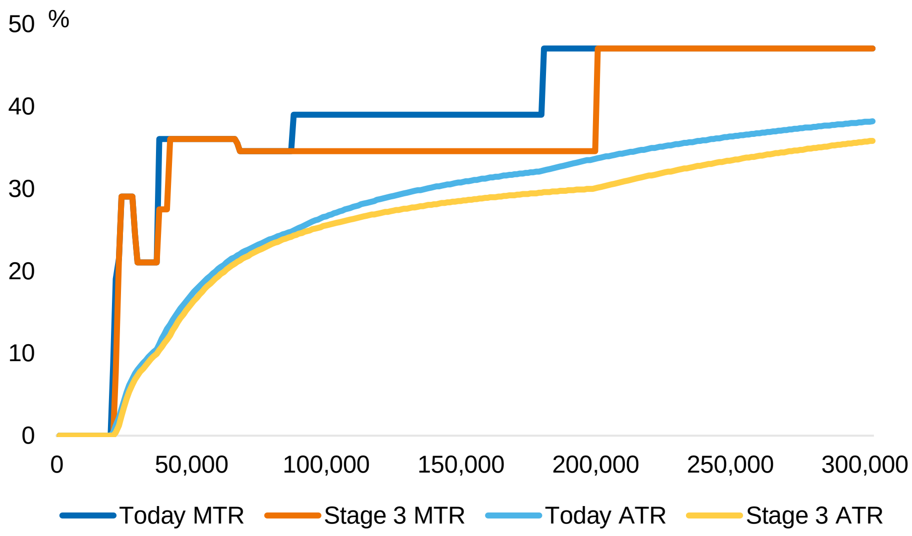
The proposed scales from 2024-25 are similar to the indicative scales in the AFTS Review, and provide scope for further reform. Further changes to personal taxes would do more to improve decisions to work, save and invest, for example by drawing on the other AFTS recommendations.

High personal income taxes discourage people from entering the workforce, working additional hours and working in Australia

The personal income tax system influences decisions to move from welfare to work, to work additional hours or seek promotion, and to work in Australia or overseas. For example, low income earners will continue to face low average tax rates but high marginal tax rates. When the transfer system is considered, effective marginal personal income tax rates can exceed 80 cents in the dollar because of the withdrawal of benefits as incomes increase, creating a barrier to people wanting to enter the workforce.

High marginal rates of income tax discourage some people from investing in skills improvement if they do not consider the eventual rewards from higher paid jobs are worth the effort. People will be reluctant to incur the cost of studying (the fees and forgone income) if they consider that the after-tax rewards are inadequate. High marginal tax rates also encourage tax planning – that is, people seek out ways to reduce their taxable income.

Figure 3: While average tax rates (ATR) are lowered, effective marginal tax rates (MTR) in the personal tax system remain high for low income earners



Note: Analysis includes the Medicare levy and low and middle income tax offsets.

An ageing population and declining participation

Like many industrialised countries, our population is ageing. An older population will drive increased government spending while reducing labour force participation and thus the capacity to pay. By 2055 there will be only 2.7 workers for every person over 65, compared with 4.5 in 2014-15.[8]

The personal income tax base will narrow further – if income tax maintains its current share of total taxes (and the overall tax burden is not significantly lower), this will mean a significantly increased burden on future income earners.

With an ageing population, we cannot afford a tax system that discourages working. High effective marginal tax rates (reflecting the interaction of the tax and transfer systems) particularly discourage workforce participation by low and secondary income earners and older workers.

Australia needs to be competitive in a global labour market

Workers, particularly highly skilled ones, have become increasingly mobile over recent decades. Immigration can increase the size of the workforce, and also bring in new skills, ideas and connections that can ultimately improve productivity and economic growth.

As labour mobility increases, tax differentials increasingly influence worker decisions about where to locate.[9] In Australia's case, the top marginal tax rate starts at around 2.2 times the average wage today, making us less attractive compared with other OECD countries. For example, the UK and Germany have similar top rates to Australia but they cut in at around 4 and 5 times average earnings respectively.

Even with the proposed tax changes, the ratio will fall to 1.9 by 2024-25 because of bracket creep. Without the changes, it will fall to 1.7. When the $180,000 threshold was introduced in 2008-09, there were 2 per cent of taxpayers in the top tax bracket.[10] Today this figure is 5 per cent and it will reach 6 per cent in 2024-25 under the proposed plan.[11]

Income tax changes are one part of a transformative tax package

Australia needs to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support the creation of jobs for the future. It's not about one tax. It's about the combination of taxes and setting an overall tax mix that is most able to achieve the goal of growing the economy and creating jobs.

The overarching objective of tax reform over the medium term must be to redesign and improve the tax system by shifting from less efficient taxes to more efficient ones. This should reduce the average economic burden of raising each dollar of revenue. This includes a progressive reduction in the company tax rate to make businesses more competitive in the global contest for investment. The full implementation of the Enterprise Tax Plan is a critical

[8] Australian Government, *2015 Intergenerational Report*, 2015.

[9] Ufuk Akcigit, Salomé Baslandze, and Stefanie Stantcheva, *Taxation and the International Mobility of Inventors*, Working Paper (Massachusetts: National Bureau of Economic Research, March 2015).

[10] ATO, *Taxation Statistics 2008-09*, 2011.

[11] Australian Government, *Personal Income Tax Plan Fact Sheet*, 2018.

element to this, particularly as other recent business tax changes have made the company tax system less competitive.

This requires a tax system that reduces the overall tax burden on investment, working and other highly valuable and productive activities.

While a tax system that promotes economic growth must be the primary objective of reform, the tax system as a whole must also be equitable, have integrity, provide a stable revenue base and be as simple as possible. Fortunately, these objectives are often mutually reinforcing, as evidenced by that fact that the biggest beneficiaries of proposed company tax cuts are Australian workers, and that the biggest beneficiaries of the proposed income tax cuts are middle-income earners.

Those opposing personal and company tax cuts are effectively arguing for higher taxes which would ultimately undermine economic growth and real wages. This would only reduce the capacity of government to deliver better and fairer outcomes for the community at large, and the most vulnerable in particular.

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